



February 25, 2010

Mr. Robert V. Newman, CPA
Executive Director
Utah Retirement Systems
540 East 200 South
Salt Lake City, UT 84102-2099

Re: Actuarial Analysis: Changes to Return to Work Provisions and Repeal of Maximum Allowance (SB 43 3rd Sub.)

Dear Bob:

You asked for our actuarial analysis of the 3rd Substitute of SB 43. This bill makes changes to the Work after Retirement (WAR) provisions of URS, and it eliminates the maximum retirement allowances in the Public Safety, Firefighter, and Judges' retirement systems.

Provisions

SB 43 (3rd Sub.) changes the Work after Retirement (WAR) provisions for all URS systems. These changes are effective July 1, 2010. Items 1 and 2 below apply to members who are reemployed retirees on the effective date. Items 3 and 4 apply to current active and retired members who are not reemployed retirees as of the effective date. Item 5 applies to all active members of the Public Safety, Firefighter, and Judges' retirement systems. The changes to the systems are as follows:

1. For full-time retirees who have already returned to work or will return to work prior to July 1, 2010, the bill repeals the requirement that the employer contribute the same percentage of pay to a defined contribution plan for the member's benefit that the employer would have been required to contribute to URS. Nothing prohibits the employer from continuing to contribute an amount to a defined contribution account for the rehired retiree, but the amount is limited to the normal cost of the plan to which the rehired retiree would have been a participant if he or she had returned to active status.
2. The original provisions of the bill required that for full-time retirees who return to work prior to July 1, 2010, the employer contribute an amount equal to the portion of the contribution rate that is used to amortize the unfunded actuarial accrued liability (UAAL). This provision has been removed in the 3rd Substitute. The net effect of these first two items is to allow the employer to save anywhere from the amortization rate to the full contribution rate that otherwise the employer would have paid to the rehired employee's DC account.
3. For retirees who return to work on or after July 1, 2010 and within one year of their retirement, the bill requires the member to return to active status and the member's retirement allowance to be canceled. If the rehired retiree remains in employment for at least

two years, he/she shall have his/her retirement allowance recalculated following the subsequent retirement. The recalculated allowance will be equal to the retirement allowance that was suspended plus an additional benefit based on the years of service earned between their first and subsequent retirement dates. Contributions will be made on behalf of the member the same as any other active member.

The bill also prohibits sheriffs and police chiefs from "retiring in place" (drawing a benefit while continuing to work on an uninterrupted basis) on or after July 1, 2010. Note that elected officials are not exempt from these rules. Also note that this provision applies to retirees reemployed on either a part-time or a full-time basis. Unlike other parts of the bill, this one is not restricted to full-time employees.

4. For retirees who return to work after July 1, 2010, but after being separated from service for one full year, the retiree will have the option to have his or her retirement benefit continue, or to return to active status. If the member elects to continue to receive the retirement allowance, the employer will be required to contribute an amount equal to the portion of the contribution rate that is used to amortize the unfunded actuarial accrued liability (UAAL). The contribution is made to the system under which the rehired retiree would have participated if the rehired retiree had returned to active status.
5. Currently a member of the Public Safety and Firefighter systems may not earn a benefit greater than 70% of Final Average Salary (FAS) and a member of the Judges system may not earn a benefit of more than 75% of FAS. The bill would eliminate these maximum benefits, effective for all members retiring on or after July 1, 2010.

Analysis – Items 1 and 2

The first two items above apply only to members who are reemployed prior to July 1, 2010. As of that date, this is a closed group of reemployed retirees which will diminish over the next few years as these members terminate and retire again. Assuming that there are about as many reemployed retirees in FY 2011 as there were in the 2008 calendar year, the employers can save the amounts shown below.

Item	Public Employees	Public Safety	Firefighters	Total
1. Number of Rehired Retirees	1,776	322	30	2,128
2. Estimated Payroll of Rehired Retirees	\$ 107.2	\$ 18.8	\$ 2.2	\$ 128.2
3. FY 2011 Weighted Amortization Rate	3.35%	7.38%	0.62%	N/A
4. Savings from Elimination of Amortization Payment (3 x 2)	\$ 3.6	\$ 1.4	\$ -	\$ 5.0
5. FY 2011 Weighted Normal Cost Rate	11.98%	21.87%	0.00%	
6. Possible Savings from Elimination of Required DC Contributions(5 x 2)	\$ 12.8	\$ 4.1	\$ -	\$ 16.9
7. Total Possible Savings to Employers (4 + 6)	\$ 16.4	\$ 5.5	\$ -	\$ 21.9

Note: Dollar amounts shown in millions

In the table above, the number of full-time reemployed retirees in FY 2011 is assumed to be the same as in the 2008 calendar year. The payroll was based on the 2008 payroll for reemployed retirees (imputed from their 401(k) contributions), projected to FY 2011 at 4.00%/year. The weighted contribution rates are the weighted average contribution rates (amortization and normal cost) for FY 2011 for all the funds in the group. For example, for Public Employees, we weighted the average contribution rates for the Local Government and the State and School divisions, and we weighted the contributory and noncontributory funds. The contribution rates used exclude both the 1.50% 401(k) contribution rate and the Group Insurance rate. The rates are the employer rates, and for Firefighters, the net employer rates after reflecting the offset for fire insurance premium taxes.

For all of URS, for FY 2011, the changes affecting the retiree group that was rehired by July 1, 2010 result in:

- No change to URS liabilities
- No additional funding for URS
- *At least* \$5.0 million in savings for the employers, due to the prohibition against contributing the amortization component of the contribution rate to the member's defined contribution account. (See line 4. above.)
- \$21.9 million in total potential savings for the employers, if employers do not make non-required contributions to the member's defined contribution account. (See line 7. above.)

Over time, as the members in this group retire for a second time, the savings will diminish, until this entire group is out of the workforce.

Analysis – Items 3 and 4

For this item, we will make use of the analysis we did last fall for the Office of the Legislative Auditor General (OLAG). There, we observed that the current WAR provisions have these two effects:

- Members receive a contribution into a defined contribution plan equal to the amount that would have been contributed to URS on their behalf
- Members often retire earlier than they otherwise would have, increasing the liabilities of the retirement system

Under this bill, employees will have less of an incentive to retire earlier than they would have, since they will not be able to work full time in a URS covered position and draw their pension, until at least one year after their retirement. (Employees would still have the ability to immediately receive a pension and a paycheck by retiring and going to work for an employer outside of URS.) Therefore, we believe the bill would result in a substantial diminishment of the number of WAR cases. These provisions eliminate the ability of employees in the future to retire and then immediately return to work with another URS employer. The bill lengthens the required time in retirement before returning to the same or another employer to 12 months, and it makes this a "hard" requirement by applying to part-time as well as full-time employment and by prohibiting the employee from doing contract work for the employer during the one-year period. We believe that most employees will choose to continue in service with their current employers rather than retiring early, sitting out a year, and then returning to work. If they wish to "double dip", the bill requires that they be able to support themselves for at least twelve months away from the job.

In the previous analysis done for OLAG, we estimated the probable long-range savings from the elimination of the current WAR provisions as follows:

System	Estimated Savings per Retiree	Estimated Annual Savings as % of Payroll
Public Employees	\$ 91,699	0.68%
Public Safety	217,325	4.64%
Firefighters	151,096	1.79%

While not all of these savings may accrue under this version of the bill, since it does not absolutely prohibit members from continuing to receive their retirement benefit after returning to work with a URS employer, we think that most of these savings will still be realized.

However, in our analysis for OLAG, we pointed out that this savings could not be built into the contribution rates all at once. The savings will follow the behavior changes (later retirements, longer working careers) that we expect to see if SB 43 (3rd Sub.) is enacted. As these occur, we would expect to see actuarial gains. By the time we prepare the experience study in 2014, we should have enough data to begin reflecting the changed behavior in the actuarial assumptions, which should produce a reduction in contribution rates at that time. (There will also be an experience study as of Jan. 1, 2011, but SB 43 would only have been effective for six months at that time, not long enough for us to gather sufficient data to see a noticeable change in retirement experience.)

Under SB 43 (3rd Sub.) retirees who have been retired for at least one year will be able to return to work for a URS employer and receive both their allowance and a paycheck. We believe that the one

year break is of sufficient length to discourage employees from retiring early with the plan of returning to work after the break to receive both their allowance and a paycheck. Retirees who return to work after one year will also have the option to return to active status. If a retiree elects to continue to receive an allowance then the employer will be required to contribute the amortization rate for that employee to URS. While this may still provide employers with some incentive to hire retired retirees (smaller retirement contribution), the provision will at least protect URS by providing contributions to help retire any unfunded liabilities that would have been received if the employer had hired a new employee instead of a retiree.

Analysis – Item 5

The removal of the maximum allowance provisions will increase the contribution rates. Attached is Table 1 detailing how the employer contribution rates would increase for the affected systems.

The base rates shown in column (2) on the attached table are the actuarially calculated contribution rates shown in our January 1, 2009 actuarial valuation report. These are not necessarily the rates adopted by the Board for FY 2011. As permitted by Utah Code Section 49-11-301(5), the Board has held the contribution rates fixed at the prior year's contribution rate if that produces a higher rate. (For this year, this only affects Salt Lake City Public Safety and those funds that contribute towards the 3% substantial substitute, so for all other funds, the rates shown are the actual employer contribution rates for FY 2011.) Column (3) shows the new actuarially calculated rates reflecting the proposal, and Column (4) shows the needed increase in the rates. If the proposal becomes law, the Board should adopt new rates that reflect the increases shown in Column (4). All calculated rates shown include, where appropriate, the contribution rate for the 3% substantial substitute, and all rates exclude the 1.50% 401(k) contribution and the group insurance contribution. The contribution rates shown for the Firefighters are the gross rates, before applying the offset due to receipts from the fire insurance premium tax. We have assumed that, as usual, the cost of providing the increase would be shared equally between the paired funds in the contributory and noncontributory systems.

The average of the increases for the Public Safety systems is 0.30%. The average increase for Firefighters is 1.19%. We expect these costs will be less than the savings from the changes to the WAR provisions.

Our analysis assumes that there will be no change in rates at which members retire. (That is, we assumed they would retire at the same rates assumed for the January 1, 2009 actuarial valuation.) As noted above, we think changes in retirement rates are likely, both because the elimination of the favorable WAR provisions removes a significant inducement to retire early, and because the elimination of the maximum allowance may encourage some members to remain in service longer. We have no way to reliably estimate these effects, so have chosen not to reflect them in our analysis. However, we expect these changes in retirement rates to have a net positive impact on the funds, other than Judges.

When we did the analysis for OLAG, they reported only one judge who was a reemployed retiree, and OLAG staff later told us this was an error. Therefore, for the Judges' System, there may be no savings from the changes to the WAR provisions, while there would be a cost from the removal of

the maximum allowance. This may not be material given the fact that the State should see significant savings for the Public Employee group.

Timing of Savings Recognition

We recognize that this analysis shows contribution rate increases due to the removal of the maximum allowances, while the savings from the changes in the WAR provisions are not recognized immediately. Nonetheless, we fully expect net savings to materialize. For the Public Employees Systems, we expect to see members staying in service for more years and retiring later. These behavior changes will ultimately be reflected in our retirement rates and should produce contribution rate decreases. In addition, over the next 3-5 years, we would expect to see actuarial gains from decreased numbers of retirements.

For the Public Safety Systems, our estimate for OLAG was that these changes would produce savings equivalent to 4.64% of payroll, far more than the average contribution rate increase of 0.30% for the removal of the maximum allowance. For firefighters, the case is closer, but still our estimated savings for OLAG of 1.79% is larger than the 1.19% average cost due to the removal of the maximum allowance.

Data and Assumptions

All of our calculations were based on the member and financial data, and the actuarial assumptions and methods, used in preparing the January 1, 2009 actuarial valuation for URS, and on the data provided by URS and OLAG related to reemployed retirees. The cost of the removal of the maximum allowance was determined as the sum of (i) the increase in the normal cost, (ii) the increase in the amortization charge determined using the 25-year amortization period and the 4.00% payroll growth rate, and (iii) the increase in the cost of the 3% substantial substitute, where applicable.

Cash or Deferred Election

Although we are not attorneys, we wanted to alert you that the provision allowing retirees who return to service after July 1, 2010 and after a one-year break may run afoul of the Internal Revenue Code. There is a general rule against "cash or deferred elections" in which members can choose between two options, one of which pays cash immediately and one of which provides a deferred benefit. (There are exceptions for 401(k) plans and for elections made upon initial employment or initial eligibility for participation in a plan, but neither of these would apply here.)

Other General Comments

Our calculations are based upon assumptions regarding future events, which may or may not materialize. Please bear in mind that actual results could deviate significantly from our projections, depending on actual plan experience.

This letter is intended to describe the financial and actuarial effect of the proposed plan changes on the retirement systems only. It is likely that over time, as retirement behavior changes, there may

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also be an impact on the cost of the post-retirement medical benefits, but we haven't tried to quantify this effect.

In the event that other changes are considered in addition to the change described herein, it is very important to remember that the results of separate actuarial valuations cannot generally be added together to produce a correct estimate of the combined effect of all of the changes. The total savings might be less than the sum of the savings from several different proposals.

Nothing in this letter should be construed as providing legal, tax, or investment advice.

If you have any questions about the above information please do not hesitate to contact either of us.

Sincerely,



Lewis Ward
Consultant



J. Christian Conradi
Senior Consultant

Enclosures

cc: Mr. Todd Rupp
Mr. Dan Anderson

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UTAH RETIREMENT SYSTEMS

**Table 1 – SB 43 – Changes in Return to Work Rules and
Removal of Maximum Percentage of Final Average Earnings**

Division/(Fund)	Employer Contribution Rate*			Compensation Projected to FY 2011	Increase in Employer Contributions [(3) x (5)]
	Current Provisions	Increase for Proposal	Total		
(1)	(2)	(3)	(4)	(5)	(6)
Public Employees Contributory System					
Local Governments (11)	9.21%	0.00%	9.21%	\$ 71,089,936	\$ -
State and School (12)	11.43%	0.00%	11.43%	71,651,766	-
Public Employees Noncontributory System					
Local Governments (15)	13.22%	0.00%	13.22%	\$ 977,848,806	\$ -
State and School (16)	15.92%	0.00%	15.92%	3,295,356,809	-
Public Safety Contributory System					
State of Utah (22)	21.20%	0.23%	21.43%	\$ 576,967	\$ 1,327
Other Division A - 2.5% COLA (23)	14.57%	0.29%	14.86%	7,905,173	22,925
Other Division A - 4.0% COLA (77)	18.10%	0.24%	18.34%	354,300	850
Logan (27)	20.69%	0.26%	20.95%	556,727	1,447
Other Division B - 2.5% COLA (29)	18.83%	0.15%	18.98%	672,003	1,008
Other Division B - 4.0% COLA (74)	23.04%	0.18%	23.22%	500,960	902
Public Safety Noncontributory System					
State of Utah (42)	32.23%	0.27%	32.50%	132,768,222	358,474
Other Division A - 2.5% COLA (43)	25.83%	0.30%	26.13%	141,777,319	425,332
Other Division A - 4.0% COLA (75)	28.55%	0.27%	28.82%	33,431,084	90,264
Salt Lake City (44)	35.44%	0.60%	36.04%	30,141,883	180,851
Ogden (45)	34.52%	0.41%	34.93%	6,234,485	25,561
Provo (46)	32.70%	0.28%	32.98%	5,541,962	15,517
Logan (47)	31.24%	0.25%	31.49%	2,296,441	5,741
Bountiful (48)	27.25%	0.48%	27.73%	2,165,538	10,395
Other Division B - 2.5% COLA (49)	28.06%	0.18%	28.24%	37,542,248	67,576
Other Division B - 4.0% COLA (76)	32.52%	0.18%	32.70%	4,835,198	8,703
Firefighters System					
Division A (31)	12.95%	0.64%	13.59%	27,632,138	176,846
Division B (32)	9.97%	1.37%	11.34%	85,819,259	1,175,724
Judges System					
	36.35%	1.45%	37.80%	15,821,446	229,411
Total				\$ 4,952,520,670	\$ 2,798,854

*Contribution rates shown are the actuarially calculated rates and do not reflect any Board action taken under U.C. Sec. 49-11-301(5).